

THE LAW AND FRANCHISING IN THE UNITED KINGDOM

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Both the United States (USA) and the United Kingdom (UK) are common law countries, but that is where the legal similarities end since the legislative changes differ considerably as do many practices in the administration of the law. The UK comprises three legal jurisdictions: (1) England and Wales, (2) Scotland, and (3) Northern Ireland. In practice, references to English law are invariably references to the law of England and Wales.

There are far more similarities than differences between the laws in these jurisdictions and the differences are manageable. Anyone involved in franchising in the UK will need to learn what are the differences and how to cope with them. In addition the UK is fed with legislation originating from the European Union which may have immediate legal effect or which need to be incorporated into UK law.

My involvement in franchising began in 1964 as I shall explain below.

I started my training as a solicitor in March 1954 straight from school. If I had then been asked what Franchise/franchising was I may well have said "having the right to vote."

Had I been asked the same question in November 1958 when I sat my final examination I would probably have said "a grant of rights from the Crown." Blackstone's commentaries explains as follows:

Franchise and liberty are used as synonymous terms and their definition is a Royal privilege or branch of the King's prerogative, subsisting in the hands of a subject. Being therefore derived from the Crown, they must arise from the King's grant, or in some cases be held by prescription, which, as has been frequently said, presupposes a grant. The kinds of them are various and almost infinite. For example:

- (a) to be a county palatine;
- (b) to hold a court leet;
- (c) to have a manor or lordship, or at least to have a lordship paramount;
- (d) to have waifs and wrecks;
- (e) treasure trove;
- (f) royal fish;
- (g) forfeitures and deodands;

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- (h) a court of one's own or liberty of holding pleas and trying cases;
- (i) to have a fair or market;
- (j) the right of taking a toll at bridges, wharfs or the like; which tolls must have a reasonable cause of commencement as in consideration of repairs or the like.

The position of the Livery companies in the City of London is worth considering as the book "The Livery of the City of London" published by the City Corporation in March 1997 points out, the Livery companies probably had their origins in England before 1066 – similar to those in Europe.

This book (see above) explained "Membership of a Livery Company carried many privileges. The usual method of entry was through apprenticeship which, when successfully completed conferred the status of Freemason free to serve any Member or to set up on his own. The Company protected standards of goods and work and effectively launched competition. In essence membership of the company gave the right to work within the City of London but to a standard which was supervised. Indeed without membership of the Livery company one could not keep a shop and exercise a trade or handicraft within the City."

It could be said that the Livery companies granted a "franchise" to the members authorising them to trade in the City to a standard consistent (by training) and associated with membership of the relevant company.

The basic concept of someone granting a licence to another permitting that other to carry out some function can be seen in many relationships of a trading nature over many centuries. Apparently, there were franchises granted to individuals in the Cornish tin mines in relation to the various steps of the process of extraction to production.

My involvement in franchising and how it came about needs to be understood as it explains how a young lawyer, as I then was, acquired the knowledge which enabled him to acquire the knowledge of what was then a new business technique developing rapidly in the USA and in the modern form with which we are now familiar when it was largely unknown elsewhere.

It was in the summer of 1963 when I was introduced to an American businessman by a client of mine. This American represented a company called "Dunkin' Donuts" which intended to set up units in the UK with a view to franchising. They needed a lawyer and after that initial meeting and discussions my firm was retained. This was my first exposure to franchising and international franchising. I already had experience of international transactions given the nature of my firm's practice.

To cut a long story short, Dunkin' Donuts decided that the gentleman they had sent to England was not producing the results which

they had hoped would be achieved. They already had a significant investment in the partly developed initial two units, one in Central London; the other in a suburban location. They asked me if I would be prepared to run their operations in the UK. We reached an agreement as I had no intention of abandoning the law and the compromise was that they would retain me for two days a week.

This gave me the opportunity to learn about franchising from the businessman's point of view in addition the depth of knowledge I had to absorb greatly assisted me in the establishing how UK law would affect or impact franchising.

It was in the November (if my memory serves me well) of 1964 that I became the Managing Director of Dunkin' Donuts (UK) Ltd. I soon reached the conclusion that franchising was likely to grow in the UK and with the knowledge and experience I was acquiring I decided that I should make it a speciality. Time has certainly reinforced that conclusion. If we look at the world in 1964 and compare it with the world in which we now live so far as franchising is concerned the transformation has been amazing – the growth which has been achieved has had a significant impact on both domestic and international markets.

Now we can travel the world and find franchising in 140 countries with different levels of understanding and sophistication. There is legislation—some of it for the right reasons and some of it with no obvious justification unless the zeal of legislators with an imperfect understanding of franchising and its dynamics whose end product creates obstacles and confusion where clarity and incentives would be preferable as an acceptable outcome.

Bill Rosenberg the creator of Dunkin' Donuts was also responsible for the establishment of the International Franchise Association (“IFA”) and through him I was introduced to the IFA at an early stage. The growth of Franchise Associations around the world and their co-operation with each other through the world Franchise Council has provided much needed leadership and many educational programmes.

My first franchise agreement—only 9 pages long—not possible nowadays as the volume and complexity of the law has expanded so much in the years since 1964.

The exposure I had as a managing director of Dunkin' Donuts UK created an awareness in the market place of my involvement in franchising. I also was well educated in franchising, the people problems, and how the relationship develops. Later in the 1960's I was asked by a publisher to write a book which we called “The Guide to Franchising” which was first published in 1970 (and is now in its 7th edition).

This awareness led not only to a flow of work in advising on and drafting agreements but also in being consulted about the day to day business problems with which franchisors were involved. This aspect of my activities continues to this day.

The contrast between the development of the law in the USA and the UK is so marked that it is worth explaining how we in the UK have coped with franchising from the legal point of view. The US lawyer for Dunkin' Donuts was a Boston practitioner named Jack Alpert who explained the issues arising under the law in the US. Since we had no real parallel I was left to work out for myself which of the UK laws would affect the transactions. Both the UK and USA are common law countries that is almost where the similarities ended. We then had easily avoidable antitrust laws and trademark laws were not the same. For example, we had no service marks at that time.

How times have changed since then and the membership of the European Union has not helped since apart from the UK and Ireland the other member states are civil law countries with civil codes parts of which cannot be contracted out of and their judges can be somewhat creative. Indeed in Germany and Austria there are concerns that the judges will apply the compensation provisions contained in the pan-European commercial agency laws by analogy even though there is no similarity between them and where the definition of a Commercial Agent clearly does not include franchises. We have no franchise specific laws other than those generated from the EU which relate to antitrust but most franchise systems have no difficulty with these laws and the regulations which are applicable.

We are not likely to have a franchise specific law in England unless it is introduced on an European wide basis imposed by the EC Commission. We have had few scandals and litigation is much less than that involving franchising in the USA.

The European Commission also has its moments in its anxiety to underline its efforts to kid itself that an area as large as the European Union with so many different countries languages and cultures is one market.

The British Franchise Association ("BFA") was formed in 1977 and from the outset it imposed a code of ethics with which its members were required to comply. Subsequently, the BFA introduced a periodic re-accreditation procedure to monitor franchisor members' performance. Not all companies which apply for membership are successful and some, but not many, have ceased to be members for various reasons.

After the BFA was formed the Banks became interested in franchising having recognised that it was a safer approach for the establishment of a new business venture. Through the franchise managers and units they established they acquired significant know how of franchising and offered franchise finance to new franchisees on competitive terms recognising the significantly reduced risk of failure. The combination of the BFA's accreditation procedures and the banks' ability to spot franchise systems about which there were doubts has been effective in limiting and possibly preventing fraudulent systems from expanding. If they are not BFA members they probably would not apply when they know what the accreditation process requires of them, the prospective franchisee

of a questionable franchise system would know that it is not a BFA member and will discover that the Banks will not grant financial assistance to him/her unless they are satisfied the franchisor is well qualified and able to perform its obligations and has demonstrated that there is a successful system.

This combination has in the writer's view made a significant contribution to minimising the risks from "dubious" franchise offers and franchisors.

For many years the relevant Government ministries have confirmed that they received few complaints about franchising. This is the case despite the fact that many doubtful business schemes fraudulently label themselves as franchises in order to attract potential victims.

In May 2007 we had further evidence of the Government's attitude to franchising. There is a parliamentary procedure, which arises at the end of the day's proceedings approaches, called an "adjournment debate" when a member can raise issues affecting a constituent. On this occasion a member raised a case where franchisees in his constituency had suffered losses and the member of parliament seemed to be suggesting that the BFA and the franchisees' bank were to blame. He advocated regulation for what was as he acknowledged such a growing important business sector. In response the minister said:

I appreciate the raising of the debate. It is important and has made me think clearly about whether we should consider more regulation of the franchising sector and whether current support is appropriate. I do not believe that the time has come for formal regulation, and I am not convinced that it would have provided the right support to the individuals who lost so much money.

We should do what we can to support franchises, because they are an important route into entrepreneurship, but at the end of the day, it is up to anyone venturing into business, whether as franchisee or independently to make their own enquiries and decide what to do in the light of their own, judgements and capabilities. Of course they should seek professional advice, from whatever source is appropriate - but whatever the advice the judgement must in the end be down to the individual making the commitment.

From the comments made by the member of parliament who raised the issue and the Minister's response it seems that the franchisees assumed, as did their member of Parliament, that as the franchisor was a BFA member and the Bank had made an offer of a loan that was enough to rely on, which of course is nonsense.

The membership of the EU results in the risk that problems in other member states may result in pan-European legislation. Some of the documents which emerge for consideration have clearly not had the impact which one would expect. An example of this sort of approach was contained in a "Proposal for a regulation on the law applicable to contractual obligations" which was presented by the European Commission [2005/0261/LOD]. There are passages to which I would draw attention clearly intended to be applicable in the absence of choice in the contract:

A contract relating to intellectual or industrial property rights shall be governed by the law of the country in which the person who transfers or assigns the rights has his habitual residence; and

A franchise contract shall be governed by the law of the country in which the franchised person has his habitual residence.

Fortunately, this proposal has been abandoned which is just as well since it is nonsense.

The EU antitrust laws apply throughout the EU and the same principles apply to the domestic antitrust laws in each member state. The pan-EU antitrust laws apply to anticompetitive practices which may affect trade between Member States (EU Treaty Article 81). There is a mechanism which authorises the European Commission to exempt practices which basically produce more benefits and allows the consumer a fair share of the resulting benefits. The Commission also has the power to grant exemption to categories of agreements subject to the conditions it may impose in the Regulation containing the exemption. (Block Exemption Regulation). There is a current Block Exemption Regulation for vertical agreements which contain vertical restraints (Commission Regulation (EC) No. 2790/1999 of 2 December 1999) which deals basically with all forms of distribution arrangements. It is unlikely there will be an individual regulation on franchise agreements as there has been in the past but the Block Exemption Regulation can be lived with by the overwhelming majority of franchisors.

The Commission published "Guidelines" which were guidance to businesses to enable them to judge whether what they would like to do would be acceptable to the Commission. Those guidelines are, at the time of writing, due for review.

As mentioned above, the volume of franchise litigation in the UK is low and pales into insignificance when compared with the USA. There is probably more litigation arising in franchising in a day in the USA than there is in a year in the UK.

There are no franchise specific laws in the UK and not likely to be any according to the relevant Minister (see above). There are anti-pyramid

selling laws which impact arrangements with more than one tier but if all franchisees are registered for Value Added Tax (a simple procedure) the arrangement is exempt and the only burden it imposes is the need to account for Value Added Tax collected from customers less (in most cases) the amount of that tax paid by the franchisee.

Many of the cases taken before the courts are not significant and only a small number have raised issues which qualify to be published in the official law reports. In other cases the Judges have applied the existing law to the facts.

There follows a review of a number of these cases to illustrate the issues and to demonstrate how the Judges have approached what for them was a new business concept. As will be seen they have grasped the special issues unique in franchising and applied existing legal principles very effectively.

These cases are those which have been brought in the High Court. The local courts which deal with the smaller cases (with a right of appeal in appropriate cases) have presented some difficulties with counsel having to spend in some cases up to a half hour explaining the concept which is franchising before the case can get under way.

The first case to which one would refer is likely to be of greater value to those practicing in the international franchising arena. The case, as will be seen, was decided 83 years ago.¹ It dealt in part with the consequences for sub-licenses when the master licence is terminated. The judgement explores the nature of a licence and sub-licenses and concluded that when the master licence terminated so did the sub-licenses.

The next case to which one would draw attention is *Office Overload Ltd v. Gunn* – a case heard in the court of first instance in 1975 and the plaintiff (the franchisor) having lost, in part, appealed to the Court of Appeal when it was successful.²

The facts and decision taken from the law report of the hearing in the Court of Appeal are set out below:

The plaintiffs, a multinational specialist employment agency, applied for an interlocutory injunction to restrain the defendant from soliciting their customers and from competing in business with them. The defendant had been their agent for a small area for a number of years, and had entered into a contract with them in respect of the agency. This contract contained a restrictive covenant under the terms of which he undertook, for the period of one year after the termination of the contract, not to compete with

¹ *Austin Baldwin & Co Ltd v. Greenwood and Baltey Ltd: the same v. Magnetic Car Company Ltd* (1925) 42 RPC 454.

² (1977) FSR 39.

the plaintiffs' business in the area concerned. He began so to compete even before the expiration of his notice to terminate, in effect continuing the same business under a new name. There was no unresolved dispute as to facts on the evidence filed. Interlocutory relief was granted in respect of soliciting but refused in respect of competing with the plaintiffs' business. Against this refusal the plaintiffs (the franchisor) appealed.

The Court of Appeal's decision is explained below.

We need not trouble you, Mr Merriman [the barrister for Office Overload]. [When the Court of Appeal makes such a statement to one of the barristers, he knows he has won the appeal.] Office Overload Ltd is a multinational company. One division of it is called Industrial Overload. It runs an employment agency of a special kind. When an employer needs urgently a skilled man. Industrial Overload will supply him. For instance, a manufacturing company urgently needs half-a-dozen welders for a special service. It will ring up Industrial Overload. They have welders on their books. They put the two parties in touch with one another. The employers take the men on for the work. The employers pay the wages (plus a profit margin for Industrial Overload) to Industrial Overload, who take the profit margin for themselves and pass on the wages to the men.

Industrial Overload have organised their business in England in defined areas. In each area they appoint men whom they call "licensees" to carry on their business in that area.

This case is concerned with the Croydon area, which is the area within a six-mile radius of Croydon town centre. In 1972 Industrial overload appointed Mr Gunn to be the licensee on their behalf for the Croydon area. He had his own office, paid his own rent, and paid his own staff. Industrial Overload allowed him to use their name and to have the benefit of their advertising, and so forth. Once he put the employers and workers into touch with one another, he dropped out and Industrial Overload did the rest. The employers paid the wages, plus profits, to Industrial Overload. Then Industrial Overload paid the men their wages. The profit was divided between Industrial overload and Mr Gunn; 56 percent of the profit went to Industrial Overload and 44 percent to Mr Gunn.

Such is the outline of the business relationship. It was governed by an agreement which started on 5 June 1972, but it was replaced by similar

agreement in 1974 and 1975. Each was for five years, determinable on 60 days' notice. In each there was a restrictive covenant, in these words:

For one year after the termination of this agreement the licensee agrees not to be connected directly or indirectly as employee, proprietor, stock-holder, partner or officer in the operation of any business competitive with Overload within the licensed area.

On 29 April 1975, Overload gave a 60-days' notice to determine Mr Gunn's licence agreement. Before that notice expired, Mr Gunn, on 13 June 1975, began a business in competition with Industrial Overload. He had all the information available. He knew the employers. He knew the workers. He claimed the right to put them in touch with one another. He did for himself all the business which previously he had done for Overload. He wrote a letter to the employers soliciting their custom. He gave himself a new name—"Plan Personnel"—but wrote from the same address as before. The letter said:

You may associate the above address with the Industrial Overload Temporary Staff Agency. To avoid any confusion, I should like to advise you that Industrial overload no longer operates from this address. We are a new agency, with a new approach, but with sufficient experience in our business to stamp us as 'professionals.'... All I ask is that you try us because I am confident of the result.

No doubt Mr Gunn was in touch with the workers, too. The judge gave an injunction against soliciting, but did not give an injunction against competing.

The first question is whether or not the covenant is an unreasonable restraint of trade. It is only for one year. So it is reasonable in point of time. It is only for Croydon, with a six-mile radius, which was his area. So it is reasonable in point of area. The only ground on which it could be said to be competitive with Overload. In master-and-servant cases the court will not restrain a servant from competing; but in a vendor-and-purchaser case, it will restrain the vendor from competing. This case is somewhat betwixt and between. The nearest to it is the case of the canvasser in *Manson v. Provident Clothing and Supply Co Ltd*.³ Lord Moulton said:

Such being the nature of the employment, it would be reasonable for the employer to protect himself against the

³ 1913A.C. 724.

danger of his former servant canvassing or collecting for a rival firm in the district in which he had been employed. If he were permitted to do so before the expiry of a reasonably long interval, he would be in a position to give his new employer all the advantages of that personal knowledge of the inhabitants of the locality, and more especially of his former customers, which he had acquired in the service of the respondents and at their expense. Against such a contingency, the master might reasonably protect himself, but I can see no further or other protection which he could reasonably demand.⁴

So here, if Mr Gunn were allowed, in this very area, to use his knowledge of and connection with employers and workers, so as to get business for himself, he would be taking unfair advantage of information which he acquired in his service with Industrial Overload. That is something against which Industrial overload are entitled to protection.

Even so, it was suggested that the clause itself was expressed more widely that was reasonable. Criticism was made of the phrase "directly or indirectly;" but I think it was only a reasonable protection. Criticism was also made of the word "stockholder" on the ground that it might prevent him from holding stock in a company in which he had no influence at all. But I must say that those criticisms carry no weight at all. It has often been said that a covenant in restraint of trade is not to be rendered invalid simply by putting forward unlikely or improbable contingencies in which it might operate unreasonably if such an unlikely or improbable event should happen, the court would not enforce it so as to work injustice.⁵ It is as simple as that. After all, a covenant in unreasonable restraint of trade is not invalid or void. It is only unenforceable. And the court will not enforce it in circumstances in which it would be unfair or unreasonable to do so.

But, as we pointed out in *Fellows*, covenants in restraint of trade are in a special category.⁶ The practice also has been that, if they are *prima facie* valid then if *prima facie* there is an infringement, the courts will grant an injunction. These cases are very rarely fought out to the bitter end. They are invariably decided at the interlocutory stage. Moreover, as Bridge L.J. pointed out, if this case were to go to trial, the whole year would be up and over before the case was tried. So the American Cyanamid case does not apply.

It seems to me that on the evidence as at present before the court, there should be an interim injunction enforcing the covenant until the trial or further order."

⁴ *Id.*

⁵ See, e.g., *Commercial Plastics v. Vincent*, 1965 1 Q.B. 623, 644 (1965) per Pearson L.J.

⁶ *Fellows v. Fisher*, 1075 3 W.L.R. 193.

The third case is another Court of Appeal decision with one of the Court (Lord Denning MR) who had also presided in the *Office Overload* case, Lord Denning was a very highly regarded creative and innovative Judge.⁷ As will be seen below in commenting that this “was the very first English case on a franchise agreement,” he had clearly forgotten the *Office Overload* case.⁸

The plaintiffs operated a world wide car hire franchise business through local companies, who provided the capital, premises and cars and paid the plaintiffs 10 per cent of the gross takings and £400 a year for advertising, instruction and other services. The first four defendants, subsidiaries of the fifth defendants, entered into franchise agreements with the plaintiffs which provided, *inter alia*, that the defendants and their directors would not, save with the express authority of the plaintiffs which, was not to be unreasonably withheld, be concerned with any other selfdrive car rental business anywhere in the United Kingdom and Eire during the agreements and that after their termination they would not engage in any such business for 180 days. After another subsidiary, the sixth defendants, had taken over the businesses of the first four defendants, one month’s notice of termination was given. By writ of 10 December 1976 the plaintiffs claimed damages and an injunction to restrain the defendants from engaging in any such business during the 180 day period. On 21 February 1977 Griffiths J refused the plaintiffs’ applications for interim interlocutory injunctions. The plaintiffs appealed.

Lord Denning MR said that the test of fairness for a covenant in restraint of trade in *Instone v. A Schroeder Music Publishing Co Ltd v Macaulay (formerly Instone)*, was relevant in deciding whether there was a substantial issue to be tried.⁹ It was the first English case on a franchise agreement which was very different to an agreement by the owner of a business. Beyond all doubt there was a very serious issue to be tried on whether the restraints were valid. The effect of not granting an injunction on other franchisees was irrelevant.¹⁰ If an interim injunction were granted and the defendants succeeded at the trial their damages would be incalculable. The appeal should be dismissed.

Geoffrey Lane LJ, concurring, said that the court was bound by *American Cyanamid Co v. Ethicon Ltd*, even though the life of the injunction might be brief and the decision on the application for an interlocutory injunction might influence future proceedings.¹¹ His lordship

⁷ *Office Overload v. Gunn*, *supra* note 2.

⁸ “Interlocutory relief: restrictive covenant: car hire franchise: interim injunction, *Budget Rent a Car International Inc v. Mamos Slough Ltd and Others*. CA – Lord Denning MR, Geoffrey Lane and Cumming-Bruce LJ 23 March 1977, Interlocutory appeal from Griffiths J.

⁹ 1 WLR 1308, 1315-1316 (1974).

¹⁰ *Schneider, Hill & Spangler Inc v. Cudmore*, 325 F. Supp. 173, 177 (1971).

¹¹ A.C. 396 (1975).

agreed with Sir John Pennycuik in *Fellows & Son v. Fisher*, as to the meaning of “status quo.”¹² Cumming-Bruce LJ, also agreeing, said that the balance of convenience came down heavily in favour of refusing an injunction. Appeal dismissed.

This extract, which was all the writer could trace is abbreviated. The writer recalls having read the judgement in the past that another issue considered was that there was a fairly short period of the restraint left to run.

It will not have escaped the readers attention that these cases concern post-termination restraints. That is what the early cases involved. The next case is *Prontaprint plc v. Landon Litho Ltd* – which dealt with the same issue.¹³

The plaintiffs operated a franchise system in association with a well known trade mark PRONTAPRINT which provided a facility for high speed printing a copying. The system was started in the early 1970s and had become established on a nationwide basis. The defendant was a former franchisee of the plaintiff who, after the expiry of his franchise agreement, had continued in business in the same premises operating the same type of service but under a new name.

Clause 17 of the agreement was in these terms:

The licensee agrees that he shall not at any time within three years of the determination of this agreement engage in or be concerned or interested directly or indirectly in the provision of the Service or anything similar thereto within a radius of half a mile of the Premises or within a radius of three miles from any Premises in the United Kingdom at which the Service or anything similar thereto is carried on by any other licensee of the licensor or by the licensor itself.

The defendant argued that although this clause was reasonable with respect to the public, it was not reasonable as between the parties and was therefore unenforceable. The defendant further argued that during the subsistence of the agreement the payments which had been made to the plaintiff were in respect of the use of the trade mark and know-how and for other assistance provided by the plaintiff; the defendants alone however had built up the business at the particular premises. Held:

- (1) There was no dispute of substance on any factual issue before the court. If the restrictive covenant was valid, the defendants were in breach of it.

¹² 1 Q.B. 122, 141(1976).

¹³ F.S.R. 315 (1987).

- (2) The success of the defendants' business had been achieved by the use of the trade mark PRONTAPRINT and by the assistance which had been provided by the plaintiffs throughout the duration of the agreement. The defendants were not merely purchasing know-how and goodwill; they were purchasing a protected interest under a franchise. By the enforcement of the covenant in issue the defendants were not going to be prevented from using any know-how that they may have acquired during the course of the agreement.
- (3) The circumstances of this case differed from those involving the sale of property; but they were closer to that situation than to the situation as between an employer and an ex-employee.

This is the plaintiffs' motion under which the plaintiffs seek an interlocutory injunction to restrain the breach of a restrictive covenant entered into by an agreement between the plaintiffs and defendants, dated 23 November 1976. The interest to which the present plaintiffs have succeeded started with the setting up of a shop in Newcastle upon Tyne in February 1971, which shop provided facilities for high-speed printing and copying. It was successful and, as a result of the experience which had been obtained, other shops were opened.

What next happened was that it was decided that the business could be suitably expanded by the setting up of franchises. Franchises were, relatively speaking, not as well known at that time as they have subsequently become and basically that happened in most cases, and what certainly happened in these cases, is that the franchisor, in this case the plaintiffs, gave assistance to other persons who may desire to operate a business of the kind which has been developed by the franchisor. This is customarily done by the way of franchise agreements of the kind which we have in this particular case.

What the plaintiffs had to offer to persons who might be interested in the taking of a franchise was the name PRONTAPRINT, which had indeed been registered as a registered trade mark, and certain publicity material, together with information which had been acquired as to the best way in which to run a business of this kind: the sort of place where it would be desirable to set up the sort of shop that would be suitable, how it could be fitted out, what sort of equipment you might require, and so on.

The defendants to these proceedings, Landon Litho Limited, are a company which was effectively set up and are run by a Dr. Landon. He is a man skilled in the field of chemistry. His doctorate was secured in the field of physical chemistry and he had been employed, shortly prior to the date upon which he entered into an agreement with the plaintiffs, in industrial research. From an information form which he supplied to the plaintiffs and indeed from the other evidence in the case, it is apparent that he knew but little about printing, buying paper, stationery and other things, and indeed

about retail selling. That information is to be found in Exhibit MAS16 to the second affidavit of Mr Spence.

The parties corresponded through October until we get to the month in which the original agreement was due to expire and, on 3 November, Dr. Landon plainly has not made up his mind, he is pressed further and eventually, on 22 November, he writes saying:

I am writing with sincere personal regret to tell you that Landon Litho Limited will not be renewing its contract with Prontaprint plc. In making this decision we have considered my approaching retirement and the future of my successors.

In breaking off the formal relationship between our companies I nevertheless offer my sincere good wishes, and those of my staff, to you and to all our friends and colleagues in Prontaprint.

There is a non-disclosure provision in clause 12 under which the defendants during the agreement after are prohibited from disclosing the know-how, but I may say that there is no suggestion that there has been any breach of this provision. There is a provision with regard to assignment, which is not of specific significance, to be found in clause 15, and indeed I can go on to clause 16, under which the defendants agreed not at any time during the continuance of the agreement to “engage in or be concerned or interested directly or indirectly in the provision of the service or anything similar thereto within a radius of three miles from any premises in the United Kingdom at which the Service or anything similar thereto is carried on by any other licensee of the licensor or by the licensor itself”, which brings me to clause 17, which is the relevant clause. It is in these terms:

The licensee agrees that he shall not at any time within three years from the determination of this Agreement engage in or be concerned or interested directly or indirectly in the provision of the Service or anything similar thereto within a radius of half a mile of the Premises or within a radius of three miles from any Premises in the United Kingdom at which the Service or anything similar thereto is carried on by any other licensee of the licensor or by the licensor itself.

Of course it is quite apparent from the language of this clause, which is simple and straightforward, that so far as the defendants are concerned there is nothing to stop them, after the determination of the agreement, from setting up a similar service anywhere, provided it is not within a radius of half a mile from the premises, that is to say, it could

undoubtedly be set up within quite a considerable part of the area indicated by the larger circle on Dr. Landon's first exhibit, and of course so far as Dr. Landon is concerned, there is no prohibition in respect of any activities of his whatsoever.

The option to renew is given in clause 26. It is an option to renew at any time not earlier than six months and not later than three months before the expiration of the agreement. In respect of the entry into a fresh agreement, the relevant words are as follows:

The position of the plaintiffs is that, this franchise having expired, what they want to be able to do is to continue to enjoy the benefit of the goodwill attaching to the name PRONTAPRINT and the businesses associated with it by granting a further franchise to some other person for the area in question and I may say that it is the defendants' evidence that the place where they are, Hanley, is the most significant and important centre for the Stoke-on-Trent area. Effectively, they say they cannot do this if what has happened is that they have entered into an agreement which, so far as clause 17 is concerned, is unenforceable. They are not going to be in a position to stop competition against any new licensee or franchisee who might be prepared to come forward.

They are further very much alarmed because what is going to be the position so far as the other—I am not sure whether it is 286 or 285—franchisees are concerned? Quite plainly, if a covenant of this kind is unenforceable, as soon as they have managed to get going on the expertise, advice and assistance given to them by the plaintiffs, other franchisees are going to either withdraw or not renew their agreements and franchising will, effectively, become inoperable. That is the position of the plaintiffs. They say that this is a perfectly reasonable restriction to protect the interest which they legitimately have in running a franchising business because, without a restraint of this kind, effectively running a franchising business is going to become impossible.

The defendants say that this restriction cannot be supported, it is wholly unreasonable and it goes much further than any question of protection of the legitimate interests of the plaintiffs. What is urged by Mr Simmonds is that, when this agreement was entered into, the plaintiffs were paid for allowing the defendants the use of the trade marks and the know-how and for the help and advantage given in setting up the business by the initial fee of £2,000 and, insofar as further assistance was given thereafter, it is said that it was a business built up by the defendants and the plaintiffs were paid for such help as was given by the 5 per cent royalty.

So it is their submission that the whole of the business, which came to an end, was a business built up by them and it is not really arguable that the defendants—effectively I think really Dr. Landon—did not make a not inconsiderable contribution to the success of this particular outlet. But the fact remains that the success that was achieved by the use of the PRONTAPRINT name, by the use of the information originally given to

Dr. Landon, the assistance originally given to Dr. Landon and indeed, on my reading of the evidence, continued. It cannot really be suggested that this business which has ultimately proved successful is not, as I understood it to be being submitted, a business which can effectively be regarded as being a business of the licensees, in relation to which it is not open to the plaintiffs to claim an interest, because they have been paid for such contribution as they made, so that at the expiry of ten years there is nothing in which they effectively have an interest which requires protection.

It is of course apparent that the circumstances of this case differ from those of the sale of a piece of property but they are, in my view, rather closer to that situation than to the situation as between an employer and an employee. The plaintiffs are in a franchising business. They want to grant franchises and have franchisees up and down the country and, for that purpose, they want to ensure that they are in a position to prevent competition against franchisees whom they might appoint by persons who in fact built up their knowledge and interest as franchisees.

If one considers what it is that the plaintiffs ought to be entitled to protect in this case, it is put on the plaintiffs' side in this way, that they ought to be entitled to protect their position with regard to the setting up of franchises for their business in an area in which, a franchise having been granted, the franchisee no longer wishes to continue to operate the franchise but wishes to be free, notwithstanding the advantages he has already secured, to compete with any possible other franchisee who might be interested in setting up in the relevant area.

It was suggested by Mr Simmonds that, effectively, what the plaintiffs are seeking to do here is to stop the defendants, as purchasers of know-how and goodwill, from using it. They were not of course purchasing just know-how and goodwill; they were purchasing a protected interest under this franchise and nobody suggests that, by the enforcement of this particular covenant, they are going to be estopped from using any know-how which they may have acquired.

If the defendants were entitled to continue in their present premises, to which I may say they have given a new name, Laserprint, they are getting an advantage because in all the local directories, including the Yellow Pages – and this is likely to continue for some little time – any body who wants printing services of this character looking in the directory is likely to find that, under the name PRONTAPRINT, the defendants would be expected to be found operating at the premises in question, and they go there. When they were there at one time they would have found a notice on the window saying: "Same Team, New Name".

I think understandably objection was taken to this by the plaintiffs and that particular notice was taken down, but still they are going to have the advantage not only of old customers going back to where they would naturally expect to find a PRONTAPRINT service operating, finding a competing service operating with the same faces greeting them and, so far

as other customers are concerned, they will go there, perhaps for the first time, on the basis of what they found out by consulting one of the directories, they will not see the name PRONTAPRINT but they may well assume that it is, in substance and effectively, the same business and they will not bother to go elsewhere. So I think it can effectively be argued that there is going to be probably an unfair advantage.

Then when it comes to the question of status quo, plainly enough, Mr Simmonds was right to urge me that effectively, if an injunction be granted, what is going to happen is that a business which has been running for ten years will be stopped. This is a position which must have been apparent to Dr. Landon. I am quite sure he has read the original agreement carefully, because it is plain on the evidence that he does proceed with care. It is a position which Dr. Landon must all along have appreciated might be going to be likely to arise when on his own motion he entered into the agreement.

I take that and I hope all other relevant matters into consideration and, in the light in part of the adverse view which I have formed of the ultimate prospects of a successful defence, but even assuming I am wrong on that and considering the factors relevant to the balance of convenience, I have come to the conclusion that this is a case in which, in the exercise of my discretion, it would be appropriate to grant the relief which the plaintiffs seek upon their motion.

The Speedy print franchises were challenged more than other business systems and as we can see the franchisees had nothing to show for their efforts except legal fees. In this respect it should be understood that under the English legal system the loser in a court case has not only to pay his own legal expenses but also those of the winner. The previous failures did not deter a Kall-Kwik Printing franchisee from picking a fight. As will be seen below a Mr Bell who took them on failed not only to avoid the by then inevitable injunction but he also failed in his attempt to involve the EU antitrust laws and to persuade the judge that the contract was void for their infringement.¹⁴ Mr Bell was perhaps unfortunate in that the judge who heard the case invariably took a very robust approach. This case is unique in that it is the only franchise case in which this antitrust issue has been adjudicated upon. The part of the judgement relevant to that issue is set out below.

The plaintiff operated a franchise system under which the plaintiff licensed franchisees to use the name KALL-KWIK and various other marks, The defendants were the plaintiff's franchisees at premises in

¹⁴ Kall-Kwik Printing (UK) Limited v Bell and Another, F.S.R. 674 (1994).

Southampton under the terms of a written franchise agreement. On 21 August 1993 the defendants closed their franchised premises and moved most of their equipment and stock to premises some 200 yards along the road. Immediately thereafter a similar business commenced at the new premises trading under the name PRINTBASE.

The plaintiff treated the defendants' conduct as a repudiation of the franchise agreement and gave notice terminating it. The plaintiff then sought an interlocutory injunction to enforce, *inter alia*, a restrictive covenant contained in the franchise agreement in the following terms:

. . . for a period of eighteen months after termination of this Agreement . . . not to engage directly or indirectly (whether as a director shareholder partner proprietor employee official agent or otherwise) in any business competitive with the Business or the Mark or the business of the Franchisor at or within a 700 metre radius of the Centre.

The defendants denied that they had acted in breach of the covenant but conceded that, on this issue, there was an arguable case. However the defendants contended that the whole franchise agreement was *prima facie* void under Article 85 EEC or that the restrictive covenant was unenforceable at Common Law. Held, granting the interlocutory injunction sought:

- (1) *Prima facie* a restriction for a period of 18 months was not longer than was reasonably necessary in order to protect the plaintiff's goodwill.
- (2) Accordingly, *prima facie*, the restrictive covenant was not within Article 85(1) EEC.

Pronuptia de Paris GmbH v. Irmgard Schillgalis [1986] 1 C.M.L.R. 414 followed.

Further, in Clause 4.13, there was an obligation "constantly to protect and any additional goodwill generated by the Franchisee for the Mark of the Permitted Name as bare trustee for the Franchisor."

In an ingenious and elaborate argument, suggested to me that simplicity was not enough. He submitted that under Article 85 of the Treaty of Rome there was a presumption that an agreement of the sort of franchise agreement here relied upon, was an agreement ". . . which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market . . ."

I have quoted those words from the phrases in Article 85(1) of the Treaty. The Article goes on to say: ". . . in particular those agreements which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development or investment;
- (c) share markets or sources of supply;”

And (d) and (e) which were not relied upon. Article 85(2) provides that “Any agreements or decisions prohibited pursuant to this Article shall be automatically void.”

Mr Powles submitted that there was here plainly a restriction limiting markets within Article 85(1)(b) because in particular the defendants were prevented by the agreement from setting up (save with the consent of the plaintiff, (which of course is not a sufficient relaxation) in business as Kall-Kwik elsewhere within the Common Market. They could not, he said, go to some town in, for example, France and set up such a business there pursuant to the terms of this contract. Thus, he observed, it must be within the Article and must be treated as automatically void within Article 85(2). However, the Common Market law as developed by the courts and by the European Commission is, regrettably, never simple, straightforward or, if I may say so, comprehensible in its effect.

First, I was referred to a text book called the Common Market Law of Competition by a Mr Bellamy of Her Majesty's counsel and a Mr Child, a solicitor (4th ed., 1993: Sweet & Maxwell). The work is of course, not authority, but it was adopted by Mr Miller as part of his argument. In particular he referred me to paragraph 2- 139 on p.122 where the authors say:

It is now well established that an agreement which would otherwise fall within Article 85(1) nevertheless falls outside the prohibition where it is unlikely either to affect trade between Member States or to restrict competition to any appreciable extent.

He referred to the principle that agreements which have a *de minimis* effect are not within Article 85 at all. It is difficult for an English lawyer to read Article 85 and say that something is not within it when, upon the face of the words in the ordinary process of English legal understanding, it plainly is within it, but that is the sort of contortion which one has to try and go through.

Mr Powles went on to observe that since Article 85(2) said that any agreement prohibited under the Article shall be automatically void, if I found anything which was within the Article, the agreement as a whole would fall. On the face of the words, I thought that his submission seemed to have some force.

However, there are provisions, and in particular a block exemption granted by the Commission, which it was said did not cover this agreement. In the block exemption, Commission Regulation No. 4087/88, Article 3(1) provides that: "Article I shall apply notwithstanding the presence of the following obligations on the franchisee, in so far as they are necessary to protect the franchisor's industrial or intellectual property rights..." In particular in 3(1)(c):

not to engage, directly or indirectly, in any similar business in a territory where it would compete with a member of the franchised network, including the franchisor; the franchisee may be held to this obligation after termination of the agreement for a reasonable period which may not exceed one year, in the territory where it has exploited the franchise;

"Ah," said Mr Powles, "the period here is 18 months; that plainly exceeds one year, so that the exemption allowed by Article 3 cannot, pursuant to (1)(c), apply, and Article 85(3) of the Treaty and the block exemption does not validate this agreement."

Further, he referred to Article 3(1)(d) which required a power to influence, and he pointed out that in this clause there is a restriction upon either of the Bells being a shareholder in a company, and he observed, perfectly fairly, that a mere shareholder may have no power to influence the conduct of a company's business at all. Somebody who holds 0.1 per cent of the shares in a substantial public company plainly has no influence whatever on the conduct of that public company's business, and yet "shareholder" would, in the words of the covenant 12.01.2 and 12.01.3, cover such a situation.

Thus, he said, that the agreement was *prima facie* void and the court should not grant interlocutory relief to enforce it. He further argued that at common law the agreement was bad. He referred to the remote branches including under 12.01.2 but I have already dealt with that submission by referring to the blue pencil test, which, in my judgment, applies to this clause.

Mr Powles submitted that the 18 months period was at common law too long and that six months was all that was necessary to protect the legitimate interests of the plaintiff. On that point I would observe that I have no hesitation in concluding that 18 months is, *prima facie*, a reasonable period to apply. I quite accept Mr Powles' basic point that the period must not be longer than is reasonably necessary to protect the legitimate interests of the plaintiff. Had the period been, for example, 25 years, I would have no doubt that it was, *prima facie*, unreasonable unless very special circumstances were set out. But a period of 18 months for a business where there is a goodwill, which goodwill is the property of the

plaintiff and which is being required by the plaintiff for the continuing conduct of business at the premises or within the 700 metres of these premises, seems to me a period of time which is highly likely to be that during which goodwill annexed to the defendants would persist; their influence upon, their reputation with, customers who need quick print and copy services would continue for so long. Upon that basis 18 months is not a time longer than is reasonably necessary.

Mr. Powles also referred me, though with suitable diffidence, to a judgment of Holland J. in a case called *GFI Group Inc. v. Eaglestone*, *The Times*, 29 October 1993. All I shall say about that is that I do not follow the rationale of the decision and do not propose to adopt any of the reasoning in it. He made submissions also about the meaning of the word “centre” and, in my judgment, the argument that there is now no centre from which the 700 metres can be measured is not sound upon the true construction of this agreement at common law.

Mr Miller in answer, on the point which is of any substance in Mr Powles observations- which is the Article 85 point- observed that there was no evidence as to trade between Member States. He referred me to *Pronuptia de Paris GmbH v. Irmgard Schillgalis* [1986] 1 C.M.L.R. 414, and the judgment of the European Court of Justice at p.438, para. [3], and p.442, paras. [15] to [18]. This was a case on franchise agreements but the court started by dividing franchise agreements into three types: service franchise agreements, production franchise agreements and distribution franchise agreements, and classified the *Pronuptia* case as a distribution franchise case. Mr Miller suggested, and I agree and accept, that this agreement is probably a service franchise agreement, so that *Pronuptia* does not directly and automatically apply to this case.

However, the court did observe that there were legitimate and proper reasons for the upholding of franchise agreements. At clause [16] the court said:

It thus follows that those clauses which are essential to prevent this risk do not constitute restrictions of competition in the sense of Article 85(1). These include the prohibition on the franchisee opening, for the duration of the franchise or for a reasonable period after its termination, a shop with an identical or similar purpose in an area where he could be in competition with one of the members of the network.

Those words plainly apply very neatly to this case as showing that these restrictions do not, according to the European Court, which is the binding voice upon the true understanding of the Treaty of Rome, come within the plain words of Article 85. The difficulty for English lawyers is always that of understanding that plain words do not mean what they say, but that is the

decision of the court which I must follow and accept. Therefore, said Mr Miller, there was no justification for saying that these restrictions, in particular 12.01.1 and 12.01.3, were within the prohibition of Article 85.

He also referred me to a decision of the English Court of Appeal in *Chemidus Wavin v. Société pour le Transformation et l'Exploitation des Resines Industrielles S.A.*, where Buckley L.J. (at p.187) and Goff L.J. (at p.189) held that, relying upon another set of decisions of the European Court, automatic nullity under Article 85(2) affects only clauses which offend the Article and leave the rest of the agreement standing to be judged by its own municipal law.¹⁵ That again is a decision which binds me. I find it quite extraordinary but it is of course the voice of higher wisdom than mine and therefore I must follow and accept it. It follows that I am to read this Article as only striking down those terms which are plainly within it.

The result, in my judgment, is that it is clear enough that there is no adequate ground for holding that the Treaty, *prima facie*, applies to this agreement. I accept that if there were a *prima facie* application it will be for the plaintiff, who has the knowledge and availability of material, to show that its agreement was not within the Treaty by reason, for example, of the *de minimis* rule and the minor share of the market. I do not, in my judgment, have to get so far, as it seems to me that it is clear enough that Article 85 has nothing to do with this case and I can therefore ignore it.

The judge gave leave to appeal but no appeal was made.

The decisions of the courts already referred to make it plain that the goodwill under English law belongs to the franchisor. There are two types of goodwill. The first is that which is associated with the name and reputation. This type of goodwill was succinctly defined in a House of Lords case¹⁶ when Lord MacNaghten explained as follows:

What is goodwill? It is a thing very easy to describe, very difficult to define.

It is the benefit and advantage of having a good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill

¹⁵F.S.R. 181, 187-189 (1977).

¹⁶IRC v Muller & Co Margarine Limited, A.C. 217 (1901).

is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates.

The other type of goodwill is that which represents the value of a business in excess of its net asset value. On a sale by a franchisee that goodwill or the going concern value of the business as some call it belongs to the franchisee.

In another case the relationship between the parties was considered.¹⁷

“The working relationship between a franchisor and franchisee should be close and requires “co-operation and good faith as between the parties to the agreement if it [is] to work effectively,” so said Sir Peter Pain in the judgment in *Body Shop International plc v Rawle* given in the Queen’s Bench Division of the High Court on 9 July 1992. Sir Peter summed up the relationship effectively. It is a contractual relationship in which the parties do better when they work together to their mutual benefit and comply with their obligations than any remedies for breach will provide for them. Indeed, whichever may “win” a dispute both will suffer to a varying degree, particularly when one considers the cost and effect of the all consuming diversion of resources from the parties’ main business objective. Ideally, the relationship between the franchisor and franchisee should be established and maintained with the long term in mind. Few franchisors will find it profitable to be at odds with their franchisees, and vice versa. Sometimes, however, the relationship breaks down and both parties may need to consider the remedies available.”

Other areas of the law which have caused difficulties in some jurisdictions around the world have not caused any problems in England. These areas would include:

- **Employment:** apart from what were clear shams trying to pretend they were franchises in the early days of franchise activities in England it is not difficult to avoid falling into the trap.
- **Fiduciary relationship:** there have been no suggestions that there is such a relationship involved. The analysis of Sir Peter Pain referred to above concludes that such a relationship would not exist.
- **Agency:** there have been no reported cases in which this has been an issue.
- **Partnership:** the statutory definition of a partnership rules out any confusion see the Partnership Act 1890¹⁸

¹⁷ *Body Shop International plc v Rawle*, Queen’s Bench Division of the High Court on 9 July 1992, unreported but on file with author.

¹⁸ “A partnership is the relationship which subsists between persons carrying on a business in common with a view of profit.”

Not all cases have the conclusion which franchisors would like to enjoy as the following case illustrates.

Unfortunately, the Court of Appeal, following *Stewart Gill Ltd v Horatio Myer & Co Ltd*¹⁹, applied the Unfair Contract Terms Act 1977 to a franchise agreement in the case of *Fastframe Franchises Ltd v Roman Lohinski*²⁰. The decision is of some importance, although the franchisor's case does not appear to have been fully presented to the Court of Appeal or, if it was, the court did not deal with the issues in its decision. The facts, were that Fastframe Franchises Ltd entered into a franchise agreement with Mr Lohinski, who withheld payment of royalty and marketing services fees because he claimed:

- (1) that the franchise agreement gave him a monopoly/exclusivity within his marketing area;
- (2) that the marketing services fund was misapplied; he complained that no advertising was placed in his area and that the advertising was on a national basis which was not much use to him and that it supported the parallel service (see below); and
- (3) that the franchisor had established a parallel service to commercial customers which infringed his monopoly.

The matter came before the Court of Appeal having been the subject of Ord.14 proceedings before Master Munrow, and on appeal from him to Harman J.

The court considered that there were arguable issues which suggested unfairness since, although the defendant's right to raise these issues was not affected, he would be obliged to pay the plaintiff what he owed without being able to set off what he claimed. If ever there was an open invitation to defendant franchisees in such cases to raise spurious issues it would be hard to find it better put. What is troubling about the decision is that the court appears to have taken the defendant's case for granted, as if there was no question that there was substance to it. Perhaps the plaintiff did not argue the point, since the court does not appear to have addressed whether there were questions as to the sustainability of the counterclaims.

The court repeats the defendant's assertion that he had "exclusive" rights. What the contract provided was that the defendant (franchisee) had "prime responsibility" for an area. The word "prime" is incompatible with "exclusivity", and the word "responsibility" is incompatible with the terms which would express a right or, as is perhaps more appropriate, the granting

¹⁹ 1 Q.B. 600 (1992).

²⁰ unreported, 3 March 1993, CA

of a licence. In addition, if there was a grant of exclusive rights the Restrictive Trade Practices Act 1976 would have applied; particulars of the agreement should have been provided to the Director General of Fair Trading; they were not; any exclusivity would thus be void.

The second issue related to advertising. The defendant's complaint was that advertising contributions were not spent on his business and in his area. Quite apart from the fact that this was not correct, the relevant provision in the contract required the plaintiff (franchisor) to spend advertising contributions on "promoting the system". How this obligation could be construed to lend credibility to the defendant's claim is difficult to fathom. Was the court's acceptance of the claim based on the fact that the plaintiffs did not raise this issue? We do not know because the issue was not dealt with in the judgment; it may be that it was not raised, and the point assumed by the court to have been conceded.

The last issue related to the establishment by the franchisor of a parallel initiative which franchisees were invited to join. For the defendant to have a valid claim under that head he would have to establish that it infringed his "exclusive rights", a point dealt with above, and that the marketing funds were wrongly applied. As to the latter, the words "promote the system" would be significant, but what was also significant and again apparently ignored, was that the plaintiff had made considerable advances to the promotional and advertising spend and had subsidised its activities.

As a separate issue, it is also to be regretted that the decision does not examine the nature of and extent to which the exemption contained in Sch.1 to the Unfair Contract Terms Act 1977 may apply to franchise agreements. The relevant text of the Schedule reads as follows:

1. Sections 2 to 4 of this Act do not extend to—
 - (a) any contract of insurance (including a contract to pay an annuity on human life);
 - (b) any contract so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest, whether by extinction, merger, surrender, forfeiture or otherwise;
 - (c) any contract so far as it relates to the creation or transfer of a right or interest in any patent, trade mark, copyright[or design right], registered design, technical or commercial information or other intellectual property, or relates to the termination of any such right or interest;

The difficulty is that the terminology in the Act does not really correspond with that commonly found in dealings in the intellectual property described. It is to be hoped that this Court of Appeal decision will not encourage; franchisees to risk jeopardising franchise networks by raising spurious claims to which the court will lend credibility by denying

franchisors enforceable judgments for sums owed. If that is the case the prospects are bleak. It is to be regretted that the Court of Appeal's decision was not based on a full analysis of franchising, which would have shown that the overriding balance was indeed correct and that the reasonableness test had been satisfied. The indications so far do not suggest that this is happening.

For all these reasons, not least the inevitability of counterclaims whether or not justified, most franchisors provide in their contracts that all payments to be made by the franchisee to the franchisor should be made without deduction or right of set-off except if there is fraud or a bona fide liquidated sum unarguably payable by the franchisor to the franchisee. If there are payments for products or other non-fee payments one would expect standard conditions of sale to apply, dealing with issues of non-supply, under-supply or faulty or defective supplies. These issues should be kept separate from fee payments, even if the franchisor receives his income from product mark-up and has no other fee income.

There have not been any reported cases since this case which have dealt with these issues.

The final case raises an issue which is novel so far as English franchise practice and available legal guidance are concerned. It is a lengthy report but the writer believes it illustrates how well the judge (who was later elevated to the Court of Appeal) understood the issues and the novelty of the solution he found which enabled the franchisees to emerge with proper compensation for their businesses and displayed a level of ingenuity to ensure an equitable outcome.

In 1998, a case involving a franchisor who had decided to withdraw from franchising was decided in the High Court.

In the 1960s, Swinton brought insurance brokers into the high street through a network of Swinton-owned branches. The first franchised branches opened in 1984 and by the early 1990s there were over 700 Swinton branches, of which the franchised branches made up approximately 300. A number of franchisees operated several branches. The franchisees were clearly an important part of the Swinton network, enabling Swinton quickly to establish a presence in hundreds of high streets throughout the country.

The litigation was a result of a shock announcement in November 1997 by Swinton to all its franchisees that it was withdrawing from franchising and that the franchisees' agreements would not be renewed as their expiry dates approached. For those franchisees whose agreements were due to expire in the forthcoming two years, Swinton confirmed they would be treated as extended and would expire on 31 December 1999, thus giving them a two-year notice period, the remainder would terminate on their expiry dates which, in some cases were not until 2005. At the time of the announcement, Swinton also made offers to the franchisees as to what it would be prepared to pay to buy the unexpired term of the franchise

agreements. The franchisees did not regard the offers as generous (to say the least).

A small number of franchisees accepted Swinton's buy-out offers but the majority rejected the offers and the remaining 62 franchisees formed an action group, the Swinton Franchise Action Association, to take action to dispute the legality of what Swinton was proposing to do. Discussions with Swinton were not successful but they had imposed a deadline of the end of February 1998 for the acceptance of offers when they would lapse if not accepted, which was fast approaching. It became clear that agreement was not going to be reached a writ had to be issued and served. An order for a speedy trial was obtained and the matter came before Clarke J. in the Commercial Court at the beginning of July 1998.

The writ sought declarations that the franchisees were entitled to exercise the right of a renewal contained within their franchise agreements or, alternatively that they were entitled to reasonable notice of the franchisor's withdrawal from franchising. And that no sufficiently reasonable notice had been given.

Swinton's franchise agreements contained an option to renew. There were three forms of franchise agreements in use and for the purposes of the issues in the case, there was little distinction between the different forms of agreement; they had just been updated over the years. There were slight differences within the renewal provisions, for example the early franchise agreements were for an initial term of 10 years.

The majority of franchise agreements contained an option in the following terms:

7.1 Provided that the franchisee shall not have been in breach of a substantial term of this agreement during the term hereof and shall not be in breach of any term hereof at the date of expiration, the franchisor hereby grants to the franchisee an option to renew this agreement (if it has not previously been determined) on the expiration of every tenth year from the commencement date hereof for an additional term of ten years provided that:

7.1.1 the franchisee shall enter into a new agreement in such a form as is currently offered by the franchisor to new franchisees.

7.1.2 such new agreement shall not require payment of the franchise fee provided in clause 3.1 hereof.

7.1.3 the franchisee shall at its expense replace or renew the office furniture refurbish the office renew repair or replace equipment office fittings and any other items necessary for and availing to the business as may be determined by the franchisor in its absolute discretion.

7.1.4 the franchisee shall give to the franchisor notice in writing of its intention to renew the agreement at least twelve months prior to the termination of this agreement.

At trial, it soon became clear that the issue of entitlement to renew turned on the construction of the proviso 7.1.1. This proviso differed slightly in later franchise agreements as follows:

The franchisee shall at least 30 days prior to the expiry date enter into a new agreement in such form as is currently offered by the franchisor to new franchisee, a copy of which for signature by the franchisees shall be supplied by the franchisor at least 60 days prior to the expiry date.

The important element of the option to renew clause at trial was the construction of the wording “the franchisee shall enter into a new agreement in such form as is currently offered by the franchisor to the new franchisees”. On behalf of Swinton, Mr Christopher Carr Q.C. argued that Swinton was only bound to renew if that proviso was satisfied. Thus, Swinton was not taking on new franchisees, no franchise agreement was “currently offered by the franchisor to new franchisees”, therefore the proviso could not be satisfied and the franchisees were not entitled to renewal.

On behalf of the franchisees, Mr Clive Freedman Q.C. argued that Swinton’s construction was too narrow as the proviso was concerned only with the form of the franchise agreement to be entered into and not the actual right of renewal. He further argued that in determining the issue of the renewal rights, it was not just a matter of reading the written clause but that the renewal clause should be construed in the context of the contract as a whole together with the factual matrix.

From the outset of the trial, it was clear that the factual matrix at the time that the franchise agreements were entered into was important. Clarke J. accepted that when construing the renewal provisions, it was necessary to ascertain the meaning which the agreement would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time they entered into the contract. In this, he followed Lord Hoffman’s approach to a factual matrix in *Investor Compensation Scheme Ltd v West Bromwich Building Society*²¹ and in *Mannai Investment Company Ltd v Eagle Start Life Insurance Ltd*.²²

Hence, the judge took into account both the documentary evidence and the oral evidence of the discussions which took place prior to the

²¹ 1 W.L.R. 896 (1998).

²² A.C. 749 (1997).

franchisees entering into their franchise agreements. In particular, prospective franchisees were encouraged to buy a Swinton franchise by the contents of the marketing literature which they were given. Promises were made such as: “. . . the satisfaction of owning your own successful business and enjoying the substantial rewards gained from your own efforts [and] when you retire or for any reason wish to sell, then you will reap the benefits of the equity you have built.” Verbal assurances were also given by the then franchise director who confirmed to the prospective franchisees that the option to renew was with the franchisee and that he could not envisage that Swinton would ever withdraw from franchising.

The judge accepted that potential franchisees expected to build up equity in their businesses which they would be able to sell in the future and he also concluded that Swinton knew that that was the franchisees’ expectation.

Other general contractual principles were debated before the judge such as “derogation from grant” and “*contra proferentum*” In addition, reference agreements, such as the franchisee’s right to assign Swinton’s entitlement to purchase the franchise at market value on the death or disability of the franchise principal. All of these clauses showed that the parties contemplated that the franchise would be a long-term arrangement likely to last for many years. The judge accepted the importance of all these matters but while expressing his considerable sympathy for the franchisees, he ruled that the franchisees’ arguments must fail because they were unable to overcome the difficulty of satisfying the proviso because Swinton were not offering agreements to new franchisees.

Mr. Freedman argued that provided the conditions precedent in 7.1 were satisfied, that is that the franchisee was not in breach of a substantial term during the contract and not in breach of any term at the date of expiration, the franchisee was granted an option to renew. He argued that provided the franchisee was willing to comply with the obligations in 7.1.1 through to 7.1.4, Swinton could not rely upon its failure to offer a contract on appropriate terms.

The problem, as the judge saw it, was that the conclusion of such arguments would be either that Swinton was to remain in franchising indefinitely or that the franchisees were entitled to a new contract on terms other than what was contemplated by the proviso. Mr Freedman argued that this would be a possibility and that they would be entitled to a new contract on either the most recent terms granted to franchisees or on reasonable terms. The judge would not accept these arguments as there was no obligation on Swinton to offer contracts to new franchisees indefinitely and offering a franchise agreement on the most recent terms or reasonable terms would be contrary to the proviso as it would not be in “such form as is currently offered by the franchisor to the new franchisees”.

Consequently, despite the factual matrix in the franchisees’ favour, the deciding factor was that Swinton had concluded that it did not want to

remain in franchising, Swinton had stopped taking on new franchisees and the judge found that it did not make business sense to “saddle Swinton with terms agreed in the 1990s for the renewal of contracts well into the 21st century long after Swinton has given up franchising”.

The second limb of the court case was the question of what notice period the franchisees were entitled to be given of Swinton’s decision to withdraw from franchising and the decision made could have important repercussions on the question of the length of a reasonable notice period. On behalf of the franchisees, it was argued that there was an implied term as to reasonable notice of Swinton’s intention to cease franchising and that in all the circumstances, such a reasonable period was 10 years. Swinton argued that any notice period should be limited to one year. They also argued that in any event, they had satisfied this requirement as they had by their announcement in November 1997 in effect given the franchisees at least a two-year notice period. There were additional complications, relevant only to this case where some franchisees franchise agreements had already expired in the early 1990s and they were holding over on the terms of their previous franchise agreement because Swinton had for many years been promising to bring into existence a new form of franchise agreement which had not yet materialised.

In determining what would be a reasonable period of notice, the judge determined that he would have to have regard to the circumstances at the time notice was given, following the principles laid down in *Martin-Baker v Canadian Flight Equipment Ltd.*²³ Swinton had long been promising a new form of a 10-year franchise agreement. They had put forward many reasons for the delay but were still talking about its introduction just prior to the announcement in November 1997.

The majority of authorities in this area of law are within the arena of employment contracts and agency and each case as to the reasonable notice is, of course, determined on its facts. The judge concluded that the relevant facts to take into account in this case, some of which would apply in all franchise situations, were as follows:

- (1) The long-term nature of franchising.
- (2) The expectation that the franchisee would be able to build up equity for the future through income and by realising capital.
- (3) The fact that Swinton would be acquiring a valuable asset from the franchisee.
- (4) The post-termination restrictions imposed upon the franchisee.
- (5) The difficulties facing franchisees in starting up their own business as the goodwill built up was that associated with the Swinton name.
- (6) The problems of competing with Swinton.

²³ 2 Q.B. 556 at 581 (1955).

The judge also concluded that it was important to take into account the fact that Swinton was projecting that it would make significant profit once it had taken over the franchise businesses. He also concluded the franchisees all had a legitimate expectation that up until November 1997, their contracts would be renewed. In determining what period of notice would be reasonable, a persuasive factor was that in any event a number of franchisees had several years left to run on their franchise agreements and that Swinton would have continuing contractual obligations to support those franchisees in any event. Conversely, he accepted that it would be wrong for him to award a 10-year reasonable notice period which would effectively grant the franchisees a new term when he had already held that there was no contractual right to a further agreement. Taking all the factual circumstances into account, he concluded that a five-year notice period was reasonable in all the circumstances.

The issues discussed in the Swinton case and their ethical implications have long been a concern to the BFA. A basic view is that the relationship should last so long as the parties perform their respective obligations which is what the Judge had very much in mind. The BFA, in considering its ethical guidance, in the 3rd edition of its book, *The Ethics of Franchising*, state, the following general principle: "...franchisees, who are in compliance with the terms and conditions of their contracts, shall have the right to realise the value of their business on transfer."

Swinton had been trying to purchase businesses from the franchisees whose contracts had expired at below the market value had the contracts been renewed. The effect of the judge's decision was to defer the effective end of the terms of the right to continue holding over until 2005 when the last of the existing contracts expired. To do so he selected a reasonable notice period of 5 years. This enabled the franchisees to negotiate a more reasonable value for their businesses. Franchise transactions involve business. The laws which affect businesses apply equally to franchises. The writer has not dealt with these laws and merely confined this paper to franchise specific legal issues.

The British Franchise Association checks out franchises which wish to become members and there is a re-accreditation procedure every two years. The Code of Ethics is reviewed and updated regularly and enforced. The BFA also has Arbitration and Mediation Schemes in position to assist in dispute resolution.

The attitude of the courts to franchising has, as is seen above, been realistic and although there are failures as they are few in number and effect as the minister responsible for franchising sees no case for regulation and long may that continue to be the case. It is not expected that this view will change.

